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UNCLAS SECTION 01 OF 02 LILONGWE 000924

SIPDIS

SENSITIVE

STATE FOR AF/S MELINDA TABLER-STONE  
TREASURY FOR INTERNATIONAL AFFAIRS/AFRICA/BEN CUSHMAN  
STATE FOR EB/IFD/ODF LINDA SPECHT  
STATE PLEASE PASS TO MCC FOR KEVIN SABA  
PARIS FOR D'ELIA

E.O. 12958: N/A

TAGS: [ECON](#) [EFIN](#) [EINV](#) [MI](#)

SUBJECT: MODEST IMPROVEMENT TO MALAWI'S MICROLENDING FUND

REF: LILONGWE 447

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SUMMARY  
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11. (SBU) The GOM recently responded to concerns about its new microfinance program by announcing that it was offering something slightly closer to commercially viable interest rates. The program has been the subject of heated political debate, on the assumption that the loans will be political handouts. While the new pricing is an improvement, it is still about half the prevailing microfinance rate, and Malawi's fragile credit culture depends on careful implementation. End summary.

12. (SBU) In a meeting with foreign diplomatic and development missions, the GOM announced that it has reconsidered the pricing of microloans offered by the Malawi Rural Development Fund (MARDEF). The GOM had publicly advertised and begun lending with a 15 percent interest rate on the loans, which are to be offered to rural borrowers in amounts ranging from MK10,000 to MK100,000 (\$83 to \$830). With Malawi's inflation running at about 15.5 percent, this amounts to a negative real interest rate.

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ADVICE SOLICITED AND IGNORED  
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13. (SBU) The GOM consulted with its development partners as it was designing the fund (which originated in a campaign promise by President Bingu wa Mutharika), and it consistently heard two concerns: that the fund should offer commercial pricing, and that it should limit the involvement of parastatal banks by offering apex (wholesale) funding to existing microfinance institutions (MFIs). The concern was that this MK1 billion (\$8.6 million) fund would grossly distort the donor-funded commercial MFIs, which are just now achieving commercial viability (see reftel). As MARDEF was rolled out last summer, though, it became clear that the GOM had ignored everyone's advice. The fund offered the heavily subsidized 15 percent rate, less than half the commercial rate, and the program was to be executed entirely through the parastatal Malawi Savings Bank. As it happens, MSB tried to interest commercial MFIs banks in the retail level but found no takers with the subsidized rates.

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FORMAL CRITICISM BRINGS A RETHINK  
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14. (SBU) Embassy mustered support within the other diplomatic and development missions to express our concerns formally to finance minister Goodall Gondwe, who responded last week by calling a meeting with the heads of mission. In that meeting, the head of MARDEF announced that he had decided to use a "flat-line" interest calculation, i.e., to use the 15 percent nominal rate for the entire principal (not just the outstanding balance) for the life of the loan. This, he said, would bring the effective rate to between 27 and 31 percent. Commercial microlending rates here are generally 40-60 percent--still up to twice MARDEF's proposed rate. Over time, the goal would be to bring the rate to 5 percent over the base rate. Embassy emphasized in response that our concern is that MARDEF operate on true cost-based pricing so as not to distort the market.

15. (SBU) Meanwhile, MARDEF has been the target of vitriolic attacks in Parliament. The political concerns are first, that Parliament was not consulted in establishing the fund, and second, that the loans were being made according to the political allegiance of the recipients. The GOM has argued against the first concern on a technicality: MARDEF is off budget because it uses dormant central bank accounts for funding. As long as it lends but does not spend the money,

it does not need parliamentary approval. The second point is mainly hypothetical, since only 3 percent of the fund has been lent, and the opposition dealt with it using spectacularly perverse logic: it enjoined the government to increase the fund five-fold, to MK5 billion (\$41 million). Government agreed, but privately told us it will reach the 5 billion figure by revolving the original 1 billion.

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COMMENT: BETTER, BUT STILL NOT GREAT  
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16. (SBU) With the new pricing, MARDEF moves closer to commercial sustainability and further from a crippling market distortion. The new pricing still undercuts commercial rates significantly, but commercial microlenders believe they can withstand the competition. Perhaps more importantly, parliamentarians' concerns arise from an unspoken problem with the lending scheme: everyone in Parliament (and arguably, nearly everyone in the country) seems to assume that MARDEF is a handout. Indeed, in the context of Malawi's credit culture, the great appeal of loans is that they are viewed as windfalls, with only a vague obligation of eventual repayment. Even more tenuous is the distinction between spending and investing. Commercial MFIs have been carefully building a healthier credit culture among their clients, and the biggest potential downside of MARDEF is the damage its careless implementation may inflict on the country's nascent credit culture.  
EASTHAM